responsibilities, we believe that the jurisdictional role of each must be parallel." NPRM at 38. This reasoning is flawed.[7]

Section 252 establishes specific requirements that competitors and states must follow. This section envisions private parties negotiating access and interconnection agreements and only if these negotiations fail does the state commission become involved through either mediation or arbitration. Preemption is permitted only if "a state will not act." Section 251(e)(5). Rather than be subject to preemption by the FCC, the states specifically are required to implement the pricing rules set out in Section 252. Further, if an aggrieved party believes a state has failed to meet the 1996 Act's mandates, the remedy lies in federal court (Section 252(e)(6), not with the FCC. Simply because Section 252 requires states to follow FCC guidelines established under Section 251, it does not logically follow that the intrastate jurisdiction of the states is preempted. When reading Sections 251 and 252 as a whole, the more appropriate conclusion would be that the FCC's guidelines should relate to interstate issues and that the states must

[7] Furthermore, the FCC has misinterpreted the meaning of the word "parallel". The statement that jurisdictional roles should be parallel is contrary to the FCC's conclusion that it should draft specific national standards. The MDPSC agrees that our roles must be parallel in the true sense of the word; a partnership where the states and the FCC share responsibility for implementing the 1996 Act. However, the tone of the NPRM demonstrates that the role the FCC envisions for itself is that of leader while the states are to follow in lock step. This approach ignores the framework established by the 1996 Act.

follow those guidelines or risk the FCC assuming responsibility. Contrary to the FCC's assumptions, there is nothing inherent in Sections 251 and 252 that necessitates preemption of the states' intrastate jurisdiction.

In sum, the 1996 Act does not nullify Section 2(b) of the 1934 Act. If anything, the 1996 Act is an affirmation that Congress intended to retain a dual system of regulation. The FCC's conclusion that its authority under Section 251 takes precedence over states' authority under Section 2(b) of the 1934 Act and Sections 251 and 252 of the 1996 Act is incorrect and not supported by legal precedent.

Conclusion

In sum, the FCC's overly preemptive approach is at odds with Congressional intent, the plain statutory language of the 1996 Act and common sense. The FCC should implement rules of general application rather than rules that unnecessarily preempt state law and regulatory policy. The FCC regulations established through this process should be the minimum requirement and should contain provisions allowing for exceptions to those requirements. Any prescriptive standards should be reserved for those instances in which a state fails to act. This approach is consistent with the evolution and mandates of the 1996 Act. Since Congress has already determined that states will play a vital role in the

development of local exchange competition, the FCC should not prescribe how every detail must be accomplished.

Minimum requirements under Section 251 will assist the states in their mediation and arbitration activities while still affording the states some flexibility to determine what is appropriate under the circumstances. Rules of general application, except where the FCC and states agree otherwise, should govern to circumvent the potential for protracted litigation regarding whether the FCC can or cannot preempt. Such litigation would create a pall over the implementation of competition and would be the greatest barrier to achieving Congress' policy goals embodies in the 1996 Act. Furthermore, minimum standards will preserve the role of the states in arbitrating and approving such agreements, as envisioned by the 1996 Act. Instead of adopting an unduly prescriptive approach, the FCC should reserve a more reasonable range of flexibility and discretion for the states.

Respectfully submitted,

Bryan G. Moorhouse
General Counsel

Susan Stevens Miller
Assistant General Counsel
MD Public Service Commission
6 St. Paul Street
Baltimore, Maryland 21202

8584 (130) Appendix A

STATE OF MARYLAND
PUBLIC SERVICE COMMISSION

ORDER NO. 71155

IN THE MATTER OF THE APPLICATION OF MFS INTELENET OF MARYLAND, INC. FOR AUTHORITY TO PROVIDE AND RESELL LOCAL EXCHANGE AND INTEREXCHANGE TELEPHONE SERVICE; AND REQUESTING THE ESTABLISHMENT OF POLICIES AND REQUIREMENTS FOR THE INTERCONNECTION OF COMPETING LOCAL EXCHANGE NETWORKS.	*	BEFORE THE PUBLIC SERVICE COMMISSION OF MARYLAND
IN THE MATTER OF THE INVESTIGATION BY THE COMMISSION ON ITS OWN MOTION INTO POLICIES REGARDING COMPETITIVE LOCAL EXCHANGE TELEPHONE SERVICE.	*	CASE NO. 8584

Before: Frank O. Heintz, Chairman
Lilo K. Schifter, Commissioner
Claude M. Ligon, Commissioner
E. Mason Hendrickson, Commissioner
Susanne Brogan, Commissioner

Issued: April 25, 1994

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A. Appearances

Andrew D. Lipman, Russell M. Blau, and Susan M. Hafeli, for MFS Intelenet of Maryland, Inc.

J. William Sarver, Michael D. Lowe, Randal S. Milch, Leigh E. Buggeln and John Walker, for Bell Atlantic-Maryland, Inc.

Allen M. Freifeld, Janice M. Flynn, and James R. Scheltema, for the Staff of the Public Service Commission of Maryland.

John M. Glynn, Theresa V. Czarski, and Frederick H. Hoover, Jr., for Maryland People's Counsel.

Karlyn D. Stanley, for AT&T Communications of Maryland, Inc.

Robert Fleishman and James P. Bennett, for Baltimore Gas and Electric Company.

Marvin M. Polikoff, for Communications Workers of America.

James E. Armstrong, Cecil O. Simpson, Jr., and Michael J. Ettner, for the Department of Defense and All Other Federal Executive Agencies.

Robert C. Lopardo, for MCI Telecommunications Corporation.

Scott J. Rafferty and Zachary Pappadeas, for Middle Atlantic Payphone Association.

Ronald A. Decker, James D. Ellis, and Paula J. Fulks, for Southwestern Bell Corporation.

Keith Townsend, for Sprint Communications Company, L.P.

B. Introduction

On July 16, 1993, MFS Intelenet of Maryland, Inc. ("MFS-I" or "Applicant") filed with the Public Service Commission ("Commission") an application for authority to provide and resell local exchange and intrastate interexchange telecommunications services in areas of the State of Maryland served by Bell Atlantic-Maryland, Inc. and, in addition, petitioned the Commission to establish specific policies and requirements for the interconnection of competing local exchange networks.

At the Administrative Meeting of August 25, 1993, the Commission determined that the application should be set for hearing. In addition, the Commission concluded that this proceeding would also serve to establish generic policies, procedures, and requirements for telecommunication carriers seeking to provide competitive local exchange telephone service in Maryland.

Also at the Administrative Meeting of August 25, 1993, the Commission determined that issues raised in a Petition by Maryland People's Counsel to Establish an Investigation of the Appropriate Means of Regulations for Firms, including Current Telecommunication Providers and Cable Television Firms which may Provide Local Exchange and Exchange Access Services in Maryland, which were not related to MFS-I specifically, would be set for hearing in a separate proceeding, Case No. 8587.

By Order No. 70723, issued on August 27, 1993, a prehearing conference was set in Case No. 8584 for September 15,

1993, at which the Staff of the Commission ("Staff") and Maryland People's Counsel ("MPC") entered their appearances, and petitions to intervene were granted to the following: The Chesapeake and Potomac Telephone Company of Maryland (now Bell Atlantic-Maryland, Inc., or "BA-Md."), MCI Telecommunications Corporation ("MCI"), Sprint Communications Company ("Sprint"), AT&T Communications of Maryland, Inc. ("AT&T"), the Department of Defense and all other Federal Executive Agencies ("DOD/FEA"), the Middle Atlantic Payphone Association ("MAPA"), Communication Workers of America ("CWA"), Baltimore Gas & Electric Company ("BG&E"), and Southwestern Bell Corporation ("Southwestern Bell").

In transmittals dated September 14, 1993, Staff, MPC, and BA-Md. listed various issues requiring resolution in Case No. 8584. The Commission directed MFS-I to address these issues in its direct testimony.

On October 14, 1993, the Commission issued Rulings on Motions and Procedural Information further clarifying the relationship of Case No. 8584 and Case No. 8587. The Commission ruled that the investigation in Case No. 8584 will be limited to matters relevant to MFS-I's application, policies regarding interconnection of competing local exchange networks, policies regarding competitive local exchange telephone service, and related issues listed in the September 14, 1993 transmittals from Staff, MPC and BA-Md. In Case No. 8587, the Commission will consider matters relevant to its jurisdiction, if any, over services which are or may be provided by cable television

companies. Case No. 8587 will encompass generic issues and policy matters, which are not germane or necessary to the resolution of Case No. 8584. Since Case No. 8584 will specifically focus on MFS-I's proposals, issues resolved here may be revisited in Case No. 8587 in regards to the provision of local exchange service by competing entities.

In accordance with the procedural schedule which was established in this proceeding, all witnesses were cross-examined on their initial, rebuttal and surrebuttal testimony on January 31 and February 1-4, 1994. Testifying for MFS-I were Alex J. Harris, Assistant Vice President, Regulatory Affairs, MFS-I; David L. Piazza, Chief Financial and Administrative Officer for MFS Intelenet of Maryland, Inc.; and William Page Montgomery, Principal of Montgomery Consulting, Chestnut Hill, Massachusetts. Testifying on behalf of CWA were Peter G. Catucci, District II Vice President of CWA and Maevon C. Garrett, President of CWA - Local 2110. DOD/FEA presented Harry Gildea, consultant with Snavely, King & Associates, while MCI presented Nina W. Cornell, economist in private practice.

Testifying on behalf of AT&T was Dr. David R. Korn, Manager, Government Affairs, in the Eastern Region of AT&T. On behalf of BA-Md. were Frederick D. D'Alessio, President and Chief Executive Officer; Elizabeth R. Beard, Manager - State Regulatory, in the Service Costs Organization of Bell Atlantic Network Services Inc.; Charles H. Eppert, III, Director - Technical Regulatory Analysis in the Technology Planning Department of the Bell Atlantic Network Services Staff; Alfred E.

Kahn, Robert Julius Thorne Professor of Political Economy, Emeritus, Cornell University and a Special Consultant with National Economic Research Associates, Inc. ("NERA"); William E. Taylor, Senior Vice President of NERA; A. Thomas Wallace, Director-Regulatory Relations of BA-Md.; Michael Fine, President of George Fine Research Inc.; and Charles L. Jackson, Principal in Strategic Policy Research, Inc.

Allen G. Buckalew, an economist at J. W. Wilson & Associates, Inc. and Robert Johnston, an economic and regulatory consultant, also with J. W. Wilson & Associates, Inc., testified on behalf of MPC. The following members of the Commission's Telecommunications Division testified on behalf of Staff: Richard L. Cimerman, Director; Steve Molnar, Assistant Director; Ann Amalia Dean, Regulatory Economist; and Geoffrey J. Waldau, Regulatory Economist.

Initial briefs were filed on March 8 and reply briefs on March 22, 1994.

The Commission has carefully considered all evidence and arguments by the parties to this proceeding to arrive at its conclusions in this case.

In its application, MFS-I proposes to offer business customers, both large and small, in various locations throughout the State, a wide spectrum of telecommunications and information management services, particularly:

(a) End User Access Services, consisting of dial tone lines, PBX trunks, and Centrex-like access lines, to business customers at various points in the specified service territory;

(b) local exchange and long distance calling services (including operator services) to customers of MFS-I's End User Access Services, as well as long-distance calling services to customers of BA-Md. by means of presubscription;

(c) Originating and Terminating Carrier Access Services which will permit other carriers to offer services or to complete calls to customers of MFS-I End User Access Services; and

(d) over time, any other local exchange or interexchange services for which MFS-I's management deems there exists sufficient customer demand.

To be able to provide such services to business customers, MFS-I requests:

1. authority to provide intrastate interexchange services;

2. authority to provide local exchange service;

3. waiver of certain provisions of the Code of Maryland Regulations ("COMAR");

4. waiver of 30-day tariff notice requirement; and

5. the Commission's adoption of interconnection policies, both operational and financial, which provide for:

   a. elimination of restrictions on use and resale of BA-Md. services;

   b. expanded interconnection to all functions of the local exchange network;

   c. ensuring competitors' equal access to numbering resources; and

   d. the requirement of reciprocal inter-carrier call terminations and access charge arrangements.

In addition, BA-Md. raises issues concerning the appropriate regulation of BA-Md. if competitive entry into the local exchange market is authorized.

We will address issues and policies in regard to the various requests in sequence.

C. **Intrastate Interexchange Service**.

By Order No. 66765, issued in Case No. 7719 on September 11, 1981, (75 Md. PSC 331) the Commission granted operating authority to MCI to provide intrastate intercity telecommunications services in Maryland, thereby opening the Maryland interexchange market to competition. Since that time, other applicants for operating authority in Maryland have been authorized to provide interexchange service under the terms and conditions originally set forth in Order No. 66765. By Order No. 66319, issued on August 10, 1983, the Commission authorized resellers of telecommunications services to apply for intrastate operating authority under the terms set forth in that Order, thereby establishing a liberal entry policy for reselling carriers to provide service in the Maryland interexchange market. Since that time, applicants deemed qualified to provide such services that were willing to abide by Commission regulations and conditions of service have been authorized to provide interexchange services and the resale of interexchange services.

With respect to MFS-I's request for authorization to provide intrastate interexchange service, most parties to this

proceeding do not raise any objections. However, two issues arose in the course of the proceeding which need to be addressed by the Commission: CWA's questioning the fitness of MFS-I to provide service in Maryland; and, MFS-I's request for expanded intrastate access service from BA-Md.

CWA's objection is based on MFS-I's corporate association with Peter Kiewit Sons', Inc. ("Kiewit"), alleging that Kiewit had engaged in acts which fall short of those of a good corporate citizen. In response to these allegations, MFS-I says that it is a wholly owned subsidiary of MFS Intelenet, Inc., which in turn is a wholly-owned subsidiary of MFS Communications Company, Inc. The common stock of MFS Communications Company, Inc. is publicly traded, but the majority is held by Kiewit Diversified Group, Inc., a subsidiary of Kiewit. MFS-I argues that there is no factual or legal basis for seeking to impute to MFS-I the alleged acts of its stockholder. MFS-I provided an affidavit of Royce J. Holland, Chairman and Chief Executive Officer of MFS-I, attesting that MFS-I is not and will not be directly or indirectly managed by Kiewit. MFS-I further points out that the Commission Staff has testified that two affiliates of MFS-I (Metropolitan Fiber Systems of Baltimore, Inc. -- "MFS-B" -- and Institutional Communications Corporation -- "MFS-ICC") have operated as public service companies in Maryland for several years without being the subject of any complaints.

We have reviewed the issue and find that CWA's allegations do not disqualify MFS-I from being authorized to provide interexchange services in Maryland. Such authority will

be granted by this Order, subject to the regulations and conditions this Commission has established for non-dominant providers of these competitive services.

In order to provide intrastate interexchange service, MFS-I requests BA-Md. to provide expanded interconnection (physical or virtual collocation) to end offices and tandem offices for special and switched access. MFS-I notes that the Commission has already mandated expanded interconnection to BA-Md.'s intrastate special access services, and requests that the Commission now also require BA-Md. to amend its intrastate switched access tariff to "mirror" the rate structure (although not necessarily the rate level) adopted by the Federal Communications Commission ("FCC") in CC Docket No. 91-213 for local transport, and to permit expanded interconnection to switched access by competing providers of local transport (as required by the FCC for interstate switched access services in CC Docket No. 91-141).

In this regard, we note that in the course of the proceeding in Case No. 8533,[1] BA-Md. committed to provide intrastate special access collocation upon bona fide request.[2]

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[1] Case No. 8533 involved a request by BA-Md. for the Commission to allow local exchange companies ("LECs") to choose the form of expanded interconnection provided to interconnectors. The choices are "physical" collocation, wherein the interconnector would obtain physically distinct space within the LEC office for the location, maintenance, and operation of its interconnection equipment, and "virtual" collocation, wherein the equipment in the LEC central office would remain under the control of the LEC.

[2] We noted in Order No. 70357, issued in Case No. 8533 on February 11, 1993 (84 Md. PSC ___), that BA-Md. has committed to provide physical collocation for intrastate special access collocation, unless there is or will be inadequate space in the office to accommodate the competitor's equipment. Where office space is insufficient, BA-Md. will offer virtual collocation. The Commission retained authority to resolve disputes concerning the type of collocation offered.

Previously, the Commission instituted Case No. 8381 to resolve MFS-B's complaint against BA-Md. for failing to fulfill MFS-B's request for a collocation arrangement and for the offering of tariffed interconnection. On September 22, 1993, the Hearing Examiner assigned to the case issued a Proposed Order dismissing the complaint. The Proposed Order (which became Commission Order No 70827 on October 25, 1993, by operation of law) states that because of various developments, the complainant asked permission to withdraw the complaint. According to information provided by counsel to MFS-I in Case No. 8584, the complaint was withdrawn because MFS-B did not have any demand for expanded intrastate interexchange access at that time.

In light of the above, and noting particularly the FCC's actions in directing expanded interconnection for interstate switched access services, we advise MFS-I to request needed expanded interconnection services from BA-Md. We direct BA-Md. to file appropriate tariffs within 30 days from the receipt of the request[3], to be based on the methodology established by the FCC for interstate access. Since Phase II of this proceeding will deal primarily with local exchange issues, we expect to review BA-Md.'s tariffs for expanded interconnection for intrastate interexchange access at an Administrative Meeting where they will be accepted or set for hearing if the reasonableness of these tariffs is contested by MFS-I or any other party.

[3] Additionally, we note that in the course of the proceeding BA-Md. said it planned to file, later this year, restructured intrastate access transport rates that would be similar to the FCC's interstate access transport rate structure.

Pending the acceptance of expanded interconnection tariffs, BA-Md.'s existing intrastate access tariffs are available for MFS-I to terminate its service on BA-Md.'s network.

In response to BA-Md.'s concern that toll traffic cannot be distinguished from local traffic, MFS-I states that it would be willing to establish separate trunk groups for local and toll termination at BA-Md.'s switches to make it easier for BA-Md. to determine the correct rates to charge.

D. Local Switched Service.

In contrast to the interexchange market, no competitive carriers have been previously authorized to provide local switched service in Maryland. Indeed, the application by MFS-I is the first to come before the Commission.

In its application, MFS-I requests that the Commission inaugurate a new era in Maryland telecommunications regulation by abandoning the "outdated ... concept of the 'natural monopoly'" in local exchange services, and by creating conditions under which both incumbent carriers and new entrants can compete freely and fairly to provide all forms of telecommunications services. MFS-I asserts that granting its application is in the public interest because expanded competition will reduce costs, increase efficiency, stimulate technological innovation, and increase the range, variety, and utility of services offered to users. MFS-I further submits that opening the local switched market to competition will also stimulate economic development in Maryland.

No party in this proceeding takes the position that MFS-I's local exchange service application should be totally denied. MPC recommends that the application be granted, but cautions the Commission to be mindful that the transition to a competitive market from a monopoly environment creates a need for interim rules to guide affected parties until a workable competitive environment is achieved. MPC maintains that the Commission must strike a balance between the public policy goals of encouraging competition and ensuring that consumers with no competitive alternatives are protected. Foremost, MPC considers it the Commission s responsibility to ensure that rates to residential customers do not rise as a result of competition and that the policy of universal service is not abandoned.

CWA does not oppose MFS-I's application, but takes the position that it not be granted or decided at this time. It is CWA's recommendation that in light of pending telecommunications legislation in the Congress and other developments in the industry, the Commission should at least postpone a final decision in granting local exchange operating authority until it can be clearly determined whether other emergent competitive alternatives will better serve the public interest with less risk to universal service and greater benefit to the American work force.

The President and Chief Executive Officer of BA-Md. testified that BA-Md. does not oppose the entry of MFS-I into the business local exchange service market in Maryland, if the Commission ensures regulatory parity and equitable ground rules

for competition. As described in more detail later, Professor Kahn and Dr. Taylor outlined ground rules BA-Md. believes necessary to ensure that competitive entry is based on sound economics and a level playing field; the witnesses cautioned against regulatory models that artificially and inefficiently stimulate competitive entry.

On brief, BA-Md. notes that MFS-I's application represents the arrival of head-to-head competition in the most lucrative segments of Maryland's local exchange market. As such, it confronts the Commission with the task of maximizing whatever public benefits can be derived from "cream-skimming" competition, while avoiding the undoubted perils that the introduction of such competition presents to the long-standing system for the provision of reliable and reasonably priced universal telephone service throughout the State.

BA-Md. asserts that the emergence of targeted competition in the business market jeopardizes the substantial contribution that business revenues provide to the shared and common costs of Maryland's ubiquitous telephone network. BA-Md. sees the Commission's task as balancing the benefits and burdens of emerging competition both in the short term (by permitting competition to go forward in a manner that minimizes the risk to contribution) and in the long term (by implementing changes to Maryland's regulatory scheme that will permit Maryland to benefit from an increasingly competitive telecommunications marketplace).

Consistent with that position, BA-Md. submits that MFS-I should be permitted to begin offering local business tele-

communications services in a manner that (i) requires a minimum of regulatory changes, and (ii) is commensurate with MFS-I's experience in the local exchange market -- as a reseller. Allowing MFS-I to provide service as a reseller will begin competition within the existing regulatory framework, and under existing tariffs. BA-Md. takes the position that any decision ordering interconnection to permit MFS-I to provide service as a "co-carrier" of local exchange service should be deferred to Phase II of this proceeding.

Staff takes the position that local exchange competition is in the public interest and that MFS-I's application is economically sound. Staff witness Waldau noted that competition can lead to lower prices, higher service quality, the creation of new services desired by consumers, increased business efficiencies and productivity, and general economic growth. Staff asserts it is unnecessary to continue BA-Md.'s monopoly protection in order to encourage it to make network investments, because MFS-I's application proves that there are investors other than the BA-Md. shareholder willing to make local exchange infrastructure investments. Staff also says the Commission should weigh the short-term costs of allowing competition against the long-term benefits: the result of that analysis, it claims, is that the long-term benefits are greater than the short-term costs. Finally, Staff opines that the Commission cannot prevent all local exchange competition, citing cellular telephone service, other radio-based technologies, and other alternatives to conventional wire-based technologies.

Before discussing the ground rules to govern the competitive entry into the local exchange market, we need to determine whether such entry is in the overall interest of Maryland's subscribers to telecommunications services.

We note that MCI witness Cornell said the public interest is served if permitting competition in the switched network makes at least some subscribers better off, with no undue detriment to the remaining subscribers. As competition will develop initially only in the business market, and even there not ubiquitously, an important consideration for our determination of the public interest is the impact or detriment that such selective competition may cause to the state-wide ubiquitous network and the affordability of the rates for basic telephone service.

One such undue detriment, of course, would be if the availability of universal telephone service in Maryland would be threatened by permitting such selective competition. To analyze the issue of affordability of basic telephone service, a brief discussion of the Federal Communications Act of 1934 (47 U.S.C. §1, et seq.) (the "Communications Act") is appropriate. The major goal of this legislation was "to make available, so far as possible, to all of the people in the United States a rapid, efficient, Nation-wide ... communication service with adequate facilities at reasonable charges ...." In other words, Congress sought to facilitate the creation of a ubiquitous telephone network which would be accessible and affordable to all. Frequently, this is referred to as the goal of achieving

"universal service." Ever since the enactment of the Communications Act, the universal service goal has been considered essential not only in recognition of the importance to an individual subscribe to have access to a telephone, but also the value to the system of being able to reach the largest possible number of other telephone subscribers, therefore creating a universal network. To achieve this goal, the Communications Act anticipates both a ubiquitous network and affordable rates. In that context, affordable rates have come to mean rates which not only subsidize the neediest segment of the population, but rates which are attractive enough for other segments of the population to make the economic choice to subscribe to telephone service. As a result of this policy goal, it was considered to be in the public interest to provide affordable rates to overall classes of customers rather than more specific targeting.

As previously noted, during the course of this proceeding various parties have raised concerns that opening up local exchange service to competition may jeopardize the future affordability of basic telephone services to customers in rural areas or to certain classes or subclasses of residential customers in Maryland. The basis of this concern is that, in competitive markets new entrants will seek to attract customers who have the potential for generating the highest profit margin. In the context of telephone service this means that new entrants will seek to serve customers who, under regulated rate structures, are being charged rates substantially greater than the marginal cost of service. These customers, having high

potential to generate profits, are the very same customers whose rates are making a significant contribution to defraying the overhead costs of the incumbent local exchange company. This phenomenon, by which new entrants target the most lucrative segments of the marketplace, is called "cream skimming." To the extent that cream skimming occurs, the incumbent carrier may have to respond by deaveraging rates. This will result in higher rates for high-cost customers. Also, as contributions to shared or common costs are diminished from customers or services lost to competitors, there will be upward pressure on rates for remaining customers and services. Thus, "cream skimming" by a competitor such as MFS-I raises the possibility that BA-Md. may have to seek increases for basic telephone rates paid by various categories of customers such as residential customers, residential and business customers in rural areas, low-income customers who receive special rates and services, or categories of customers with high-cost and low-usage characteristics. Therefore, in evaluating whether MFS-I's proposal for local exchange competition is in the public interest, we must consider the extent to which it is possible or probable that some BA-Md. customers will be impacted by rate increases to the extent that the goal of universal service will be jeopardized.

In recent years, a State program (Tel-Life)[4] and two federally sponsored programs (Lifeline and Link-up Programs) have been established to meet the needs of low income customers, in

[4] Tel-Life was first authorized by the Maryland General Assembly in 1985. See Md. Ann. Code art. 78, Section 16A.

order to encourage them to join the network. Due to the structure of and sources of funding for these programs, opening the local exchange network to competition should have no detrimental effect on these subsidies. For example, Tel-Life is funded through the State's general treasury by means of a credit against gross receipts taxes paid by local exchange carriers. Since none of these programs are dependent upon revenues which are collected through the rates paid by BA-Md.'s customers, program funding is insulated from impacts local exchange competition may have on BA-Md. revenues from other customer classes.

Apart from concerns about low-income customers, we now analyze the affordability, in general, of basic telephone service in Maryland.

Staff witness Dean testified that FCC surveys showed a 1992 Maryland telephone service penetration rate of 96 percent, tied for eighth highest in the country. This has been possible by keeping rates for basic service affordable. (Even at these rates, statistics show that there are more households that have a TV set than a telephone.)

Various parties expressed their views as to the rate levels which constitute affordable rates. In Maryland, with minor exceptions, basic rates have not increased since Order No. 67033, issued in Case Nos. 7851 and 7816 in 1985. See 76 Md. PSC 238, at 291-292. Despite the imposition of federally mandated subscriber line charges on basic service customers, the penetration rate remains high. We, therefore, conclude that the

basic rates presently in effect are affordable and attractive to the large majority of subscribers.

In recent years, our ratemaking has placed increasing emphasis on cost-based rates rather than value of service rates for basic, non-competitive services. To that end, we have begun to employ an embedded fully distributed cost allocation methodology to assure that all services, including those determined as competitive (and, therefore, permitted to be flexibly priced) bear a fair share of shared and common embedded costs. Rates for other-than-competitive ("OTC") services are determined on the revenue requirements which include the shared and common costs allocated to the other-than-competitive portion of the business. However, OTC pricing is not necessarily dictated by the results of the embedded cost allocation. For example, residential rates continue to be residually priced to some extent, while preferred telephone number service is priced on a value of service basis.

For many years, the effect of residual pricing of basic telephone service has been to avoid the imposition of higher rates for those services. This is because contributions from other services in the OTC category have helped to defray a portion of shared or common costs which otherwise might have to be recovered in rates for basic telephone service. Also, to an extent which is not clear in the evidentiary record in this proceeding, residual pricing, combined with reliance on the average-embedded-cost methodology, may have resulted in some subclasses of customers receiving basic telephone service at rates below direct incremental costs. Finally, as part of our

residual pricing approach, the cost of basic telephone service has been partially defrayed by the imputation of profits from Yellow Pages advertising.

The Yellow Pages component of residual pricing of residential rates is important to note. Over the years, including the last rate case, Case No. 8462, 84 Md. PSC ___ (1993), the Commission has imputed profits from Yellow Pages advertising to offset the other-than-competitive revenue requirements. Although BA-Md. protested in Case No. 8462 that such imputation was no longer reasonable, the Commission retained an imputation, finding that it constituted a continuation of past practices which had been conceded for many years by the telephone company as an appropriate offset to basic service costs. While it may be argued in the future that such Yellow Pages subsidization of basic service is no longer feasible in light of the changes in the telephone industry, the subsidy is not immediately threatened by the foray of local exchange competitors in BA-Md.'s territory. Approval of MFS-I's application should not reduce the level of Yellow Pages' profits utilized in our decision in Case No. 8462.

Pursuant to the regulatory scheme under which BA-Md. is operating, the Company is entitled to a reasonable opportunity to recover in its rates all reasonable costs of service, including shared and common costs. Shared costs are costs associated with one physical asset which produces two or more products or services. The costs can be attributed on a cost causative basis to the several products or services as a whole, but cannot be